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Approved For Release 2001/03/17 : CIA-RDP82-0045006-4

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02-0408

CLASSIFICATION

CENTRAL INTELLIGENCE AGENCY

INFORMATION REPORT

REPORT NO.

CD NO. 25X1A

COUNTRY China

DATE DISTR. 22 March 1950

SUBJECT Factions in the Leadership of the Chinese Communist Party

NO. OF PAGES 2

PLACE ACQUIRED 25X1C

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NO. OF ENCLS. (LISTED BELOW)

DATE OF INFO.

SUPPLEMENT TO REPORT NO.

25X1X

1. While MAO Tse-tung was negotiating with the USSR in Moscow the two factions of the Chinese Communist Party (CCP) which have existed during the past several years began to stand out sharply. The one faction, now spoken of as the Internationalists, believes that China must maintain a close alliance with the USSR; the other, termed the Nationalists, believes that China must keep clear of all foreign alliances. The Internationalists, who have been losing ground in the past months, now appear to be in a position so that to bring the Nationalists into line with their policies they must commit the country irrevocably by an attack within the next few weeks on Indochina.
2. The differences between the two factions is sharpened by the severity of the internal economic crisis and the widespread internal unrest consequent to it. The most fundamental cause of the crisis is the dislocation of the national economy resulting from the severance of normal economic relationships between China and the Western nations, relationships with which Chinese economy as a whole is closely integrated.
3. These relationships were broken off by the blockade of Shanghai by the Nationalist Government and by the foreign trade policies of the Chinese Communist Government. The burden of the support of the coastal cities, Shanghai especially, then was placed by the Communists on the rural economy, which was already strained by its having had to support the armies both with manpower and grain. By now, therefore, rural areas throughout China are in open rebellion against the Communists over the question of taxes.
4. Conditions of dissatisfaction also exist in the cities where taxation is considered extortionate in its confiscation of commercial and industrial capital, resulting in the dislocation of production and distribution throughout the country.
5. The crisis has also been built up by the incompetence of much of the personnel of the Chinese Communist Government, central, provincial and municipal.
6. Under these circumstances, then, the CCP is now forced to make important

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Document No. 008

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By: 008

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Next Review Date: 2008

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policy decisions, with present conditions confining them to the following two main courses of action:

- a. They can continue their present foreign and domestic policies, which includes the maintenance of the armies at their present strength for the occupation of Hainan and Taiwan and to move into Southeast Asia, as well as to maintain internal order. This course is clearly beyond the capabilities of the national economy to support.
 - b. They can abandon their policies requiring heavy government expenditures, seek some sort of political and economic rapprochement with the Western nations, and concentrate all their efforts toward stabilizing the internal conditions of the country.
7. The Internationalist group of the CCP favors the first course; the Nationalist group believes the second course is necessary if not desirable. The Internationalists have enough control of the CCP machinery to make their views prevail and secure at least formal adoption of their policies. This control is being constantly reinforced by the arrival of more and more Soviet advisers.
 8. The strength of the Nationalists is found mostly in the military leaders, whose control over significant segments of the armies makes it possible for them to act independently. They can at least forestall a CCP purge by the Internationalists.
 9. In the near future the Internationalists will probably make a move, so that the Chinese Communist Government is committed to a course of action in which no peace with the militant non-Communists will be possible and in which the Western nations will be irrevocably alienated. It is believed that the decision to proceed in this manner has already been adopted and action is already being taken. The first manifestation will be a massive attack on Taiwan** to get the participation of the Soviets, at least of an air arm. At the same time, or nearly at the same time, Communist armies will enter Indochina.

25X1A. [REDACTED] Comment. [REDACTED] asserts that TUNG Pi-wu is a leader of a Nationalist faction of the CCP, and is a spokesman for it. This report also indicates that LIN Piao, LIU Po-cheng, PENG Te-huai and CHEN Yi are military leaders of TUNG's persuasion. [REDACTED] independent of that of [REDACTED] had heard the same report from TUNG [REDACTED] the Nationalists in the CCP. [REDACTED] TUNG's words have reached the ears of a representative of an international news service and that the success of TUNG's political maneuver is thereby jeopardized.

25X1A [REDACTED] that the Communists have perfected a plan for large scale desertions of the Nationalist forces on Taiwan at the time of the landing of Communist troops.

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